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In the Supreme Court of the United States

OCTOBER TERM, 1975

MARSHALL FOODS, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

ROBERT H. BORK,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

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The sole issue presented by the petition is whether amounts petitioner received under a business interruption insurance policy are taxable as ordinary income, as the decision below held, and not as capital gains from the involuntary conversion of property used in its trade or business.

The pertinent facts are as follows: During 1966, petitioner had business interruption insurance policies in effect covering its egg-drying plant. The policies provided for the payment of a stated amount for a maximum period of 180 days in the event of a total or partial suspension of business as a result of the de-

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struction or damage to the plant by fire or other specified perils. Petitioner also maintained insurance covering damage to its physical property. The stated per diem payment for the business interruption insurance was derived by taking an average gross income figure based upon the average production from the insured plant and reducing that amount by various expenses that would not be incurred during an interruption in operations, such as ordinary payroll. The resulting amount was then divided by the number of working days in a year (Pet. App. A–6).

Petitioner's plant was damaged by two fires in February and September, 1966, which resulted in suspension of production. Pursuant to the business interruption policy, petitioner received $506,530.73 and $620,000, respectively. Petitioner accrued these amounts as long-term capital gain in its taxable years ending March 31, 1966, and March 31, 1967. On audit, the Commissioner determined that these amounts were taxable as ordinary income. In this refund suit, the district court upheld the Commissioner's position (Pet. App. A–5 to A–12), and the court of appeals affirmed *per curiam* (Pet. App. A–13 to A–14).

Section 61(a) of the Internal Revenue Code of 1954, 26 U.S.C., defines gross income as "all income from whatever source derived." As this Court has repeatedly stated, Congress has imposed no limitations as to the source of taxable receipts and no restrictive labels as to their nature. See, *e.g., Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 429–430. It is well settled that the tax characterization of amounts received as compensation for a loss is identical to that of the amounts

they are intended to replace. *Hort* v. *Commissioner*, 313 U.S. 28. Thus, the lower federal courts have uniformly held that insurance proceeds received as compensation for the loss of profits resulting from the partial or total suspension of a business are taxable as ordinary income. *Shakertown Corp.* v. *Commissioner*, 277 F. 2d 625 (C.A. 6); *Massillon-Cleveland-Akron Sign Co.* v. *Commisioner*, 15 T.C. 79; *Miller* v. *Hocking Glass Co.*, 80 F. 2d 436 (C.A. 6), certiorari denied, 298 U.S. 659.

Here, the conclusion of the district court that the payments in question were a substitute for the income petitioner lost as a result of its business interruptions is well supported by the evidence. Under the policy, the daily indemnity payments reflected the anticipated daily gross earnings that petitioner would lose as a result of a suspension in its production minus the cost of goods sold and other production costs that would not be incurred during the suspension. The indemnity payments thereby provided petitioner with an amount equal to anticipated gross earnings. The earnings themselves would have been taxable ordinary income; the insurance proceeds, which were designed to take the place of those earnings, are also taxable as ordinary income.

Petitioner contends (Pet. 10–[illegible]) that the payments in question represent proceeds from the involuntary conversion of "property" which is taxable as long-term capital gain under Section 1231 of the Internal Revenue Code of 1954. In petitioner's view, the "property" is the right to use its plant. However, peti-

tioner's right to use its plant cannot be conceptually distinguished from its ownership interest. Since the latter interest was not involuntarily converted as a result of the fire, there is no basis for its contention that the insurance payments were to compensate it for the destruction of its right to use the plant.

Petitioner's contention is expressly refuted by the undisputed fact that the insurance proceeds were intended to recompense it for the lost profits incident to the loss of the use of its plant and not for any physical damage. At all events, this Court has held that the right to use property "is not a capital asset, but is simply an incident of the underlying physical property, the recompense for which is commonly regarded as rent." *Commissioner* v. *Gillette Motor Co.*, 364 U.S. 130, 135. Thus, petitioner's right to use its property does not constitute "property" within the meaning of Section 1231.[1]

[1] Petitioner asserts (Pet. 10–11) a conflict between the decision below and *Shakertown Corp.* v. *Commissioner*, *supra*. That case involved Section 112(f) of the 1939 Code, the predecessor of Section 1033, which provides for nonrecognition of gain on the involuntary conversion of property if the proceeds are reinvested in "similar property." While *Shakertown* suggests that an insurance payment for loss of the use of property may be covered by Section 1033, this case is governed by this Court's subsequent decision in *Gillette Motor Co.* that the right to the use of property does not constitute property for purposes of Section 1231.

Petitioner further relies (Pet. 13–19) on cases such as *Piedmont-Mt. Airy Guano Co.* v. *Commissioner*, 3 B.T.A. 1009 and *Flaxlinum Insulating Co.* v. *Commissioner*, 5 B.T.A. 676, decided under earlier statutory predecessors of Section 1033. These cases do not speak to the tax characterization of the proceeds resulting from an involuntary conversion, but instead focus on the circumstances in which nonrecognition can be achieved.

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

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